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In the Supreme Court of the United States

OCTOBER TERM, 1955

No. —

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ESTATE OF JACOB J. DIX, DECEASED

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit.[1]

[1] This case was consolidated for hearing and decision with the companion case, *J. J. Dix, Inc.* v. *Commissioner*, in both courts below, all the issues involved in the latter having been decided in favor of the Commissioner. (R. 3, 7, 9–38, Appendix, *infra*, pp. 1a–6a.) The corporate taxpayer's petition for a writ of certiorari to the Court of Appeals for the Second Circuit in that case was filed in this Court on August 13, 1955 (No. 321, Oct. Term 1955).

The record citations herein refer to the separate joint Appendix (record on review) filed by both taxpayers in these cases together with their joint brief in the court below.

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court of the United States (R. 9–38) are not officially reported. The opinion of the Court of Appeals (Appendix, *infra,* pp. 1a–6a) has not yet been officially reported.

JURISDICTION

The judgment of the Court of Appeals was entered on June 2, 1955. (Appendix, *infra,* pp. 6a–7a.) The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the deceased taxpayer realized taxable income when he secretly misappropriated for his own use and benefit funds from a family-owned corporation in which he had a beneficial interest and over which he, as president and treasurer, exercised complete domination and control.

STATUTES INVOLVED

Revenue Act of 1938, c. 289, 52 Stat. 447:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also

from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

* * * * *

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3176 of the Revised Statutes, as amended.

Sections 22 (a) and 293 (b) of the Internal Revenue Code of 1939 (26 U. S. C. 1952 ed., Secs. 22, 293), applicable to the taxable years 1939 to 1945, inclusive, are substantially the same as Sections 22 (a) and 293 (b) of the Revenue Act of 1938, *supra,* applicable to the taxable year 1938.

STATEMENT

The pertinent facts as found by the Tax Court (R. 12–24), based on those stipulated by the parties (R. 12) and upon the evidence (including exhibits) adduced at the hearing, may be summarized as follows:

The decedent-taxpayer, Jacob J. Dix (herein called the taxpayer), was president and treasurer

and controlled the affairs of a family corporation, J. J. Dix, Inc. (hereafter referred to as the corporation), a New York corporation engaged in the manufacture of paper boxes. His son, Monroe L. Dix, was vice-president and a director of the corporation. The corporation's stock was owned by Monroe and two other children of the taxpayer. Although the taxpayer owned none of the corporate stock directly, he had a life estate in a trust owning one-third and later one-fourth of the corporation's outstanding stock, under which he was entitled to the dividends for his life. (R. 12–14.)

During the taxable years 1938 through 1945, the taxpayer, through his position of dominance over the affairs of the corporation, appropriated to his own use corporate funds of approximately $56,000. (R. 14, 25.) He accomplished this in the following manner:

The corporation's regular business bank account was maintained with the Manufacturers Trust Company. In 1938, the taxpayer opened a separate bank account in the name of the corporation with the Sterling National Bank and Trust Company. This account was closed in 1942. Thereafter, in 1943, he opened another account in the name of the corporation with the Public National Bank. This account was closed in 1945. Deposits of corporate funds were secretly made by the taxpayer in the latter two bank accounts in the total sum of $196,870.60 during the years

1938 through 1944 so that the Manufacturers Trust Company, the corporation's regular banker, would not know that another bank account existed. None of those secret deposits was ever reflected on the corporation's books or reported on its tax returns for any of those years. All of the deposits made by the taxpayer in these secret bank accounts represented proceeds of merchandise manufactured and sold by the corporation in the regular course of its business. (R. 14, 15, 20.)

All checks drawn on these secret bank accounts were signed by, and a substantial number were drawn to the order of, the taxpayer and/or his son Monroe, and many were drawn to cash. The taxpayer drew numerous checks on the corporation's unrecorded account at the Sterling National Bank and deposited the funds in his individual bank account at the Bronx County Trust Company. Monroe, drawing checks from time to time on the corporation's regular business account, also drew checks on the secret account in the Sterling National Bank as well as on other banks, and turned the funds over to the taxpayer. During 1939–1944, Monroe also drew checks, made payable to the taxpayer, in excess of $33,000 on his own personal bank accounts, which were deposited in the taxpayer's personal bank accounts. Monroe had no knowledge of how the taxpayer spent this money. (R. 14–15.)

The taxpayer had said that he had opened the two secret bank accounts because he was going

to use the deposits for purposes which he could not reveal. He also declared that he was paying extra amounts of money to waste paper dealers, but the records of the corporation failed to reflect any such payments. No items drawn from the corporation's secret bank accounts were identified on the corporation's books. The taxpayer never informed Monroe of the fact that all the corporate sales were not being recorded on the corporation's books. (R. 20.) Moreover, the amounts withdrawn by both the taxpayer and Monroe from the two secret bank accounts were not reflected on any of their personal tax returns filed for the years 1938–1945, or in the net worth of either. (R. 16, 21–22.)

In April, 1945, Monroe first discovered that the deposits in and the withdrawals from the two secret bank accounts were not recorded on the corporation's books. The taxpayer was then spending considerable sums of money, and Monroe asked him for an accounting, but it was refused. Considerable disagreement arose between the taxpayer and Monroe and the corporation's accountant concerning the failure to record its gross sales and costs, but the taxpayer nevertheless refused to disclose what he had done with the unrecorded corporate funds. (R. 21.)

The taxpayer was the dominant person in the management and control of the corporation and his son Monroe was subordinate to him. The taxpayer, who had a weakness for gambling,

went to Florida on annual vacations for several months each winter and received money for these trips from Monroe. Because of the taxpayer's total domination of the corporation, however, no attempts were made by Monroe to curtail his father's lavish expenditures. Personal checks were drawn by the taxpayer to hotels and gamblers in Florida, and he purchased travelers' checks totaling as much as $10,000 in each of the years 1944 and 1945 alone. Moreover, Monroe purchased American Railway Express travelers' checks totalling $10,000 in 1944 for the taxpayer's convenience with funds derived from the secret bank accounts. Monroe, however, did not know how the taxpayer spent the money thus obtained. (R. 21, 35–36.)

After the taxpayer's death, cash in the sum of $25,500 was found in a vault kept in the name of his stepdaughter. Monroe, a co-executor of his father's estate, was unaware of the existence of this money prior to the taxpayer's death. (R. 21, 36.)

It was conceded in the Tax Court, on behalf of the taxpayer, that the corporation realized gross income from sales receipts to the extent of the deposits made by the taxpayer in the two secret bank accounts in the total sum of $196,-870.60, and that none of these receipts was recorded on its books or included in gross receipts as reported on its tax returns filed for the several taxable years involved. (R. 14, 25.) Of the total

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amount deposited to the corporation's credit in the secret bank accounts, approximately $135,000 was shown to have been spent on the corporation's behalf. (R. 26–33.) The balance of these funds, however, had been withdrawn by the taxpayer from the corporation's secret bank accounts and was neither returned by him to the corporation nor expended on its behalf. (R. 35–36.)

The Tax Court determined that the missing portion of the money, approximately $56,000,[2] had been appropriated by the taxpayer for his own purposes and represented income which was taxable to him under the broad provisions of Section 22 (a) of the Revenue Act of 1938 and the Internal Revenue Code of 1939, *supra*. (R. 35–37.) The Tax Court also found fraud against the taxpayer (as well as the corporation) (R. 24, 37–38), and charged him (and the corpora-

[2] This net amount ($56,736.02) charged against the decedent-taxpayer as taxable income (R. 35–36) represents the difference between the total corporate receipts exceeding $196,000 secretly banked by him (R. 14, 25) and the various items totalling $134,816.37 proved as having been expended by him in behalf of the corporation (R. 26–27, 30, 32–33, 35), less the sum of $5,317.41 claimed by Monroe to have been paid out by him in behalf of the corporation during 1943–1945 (R. 19). The latter amount was disallowed by the Tax Court for lack of proof (R. 29), and the court below affirmed (Appendix, *infra*, p. 3a).

It was agreed by the parties in the Tax Court that all such funds which were taken by the taxpayer and were not returned to or expended on behalf of the corporation were withheld from and were due the corporation by the taxpayer. (R. 22, 36.)

tion) with 50% fraud penalties, under Section 293 (b) of those statutes, *supra,* as statutory additions to the deficiencies in taxes redetermined against him for all years involved (R. 40, 39). The court below reversed, holding that this money had been embezzled by the taxpayer and did not represent taxable income to him. (Appendix, *infra,* pp. 4a–5a.)

REASONS FOR GRANTING THE WRIT

In *Commissioner* v. *Wilcox,* 327 U. S. 404, a divided Court held that an embezzler was not liable for income tax on the sums embezzled. In *Rutkin* v. *United States,* 343 U. S. 130, a divided Court held that an extortionist did receive taxable income and (p. 138) limited *Wilcox* "to its facts." Because the decision below is in conflict with the decision of the Third Circuit in *Kann* v. *Commissioner,* 210 F. 2d 247, certiorari denied, 347 U. S. 967, because the court below, notwithstanding that this Court limited *Wilcox* to its facts, has applied the *Wilcox* decision to the totally different circumstances of this case, and because of the well-founded uncertainties that exist in the lower courts whether *Rutkin* and *Wilcox* can be reconciled, the decision below raises problems of importance to the revenue and should be reviewed by this Court.

1. The decision below is in direct conflict with *Kann* v. *Commissioner, supra.* That case likewise

involved misappropriations of corporate funds by the principal officers from two wholly-dominated family corporations, and the Third Circuit—Judge Kalodner dissenting—held that their misappropriations resulted in the receipt of taxable income under the rule of the *Rutkin* case. The court there considered that this Court's earlier decision in *Wilcox* was distinguishable on its facts,[3] and that it was not material to determine whether the taxpayers in *Kann* were technically guilty of embezzlement under local law, although it did point out that there was no external evidence that such an offense had been committed, there having been, as is also true in the present case, no indictment or conviction or even any indication of pressure for prosecution by the other stockholder-members of the taxpayer-officers' families.

Kann and the present case are on all fours, except for immaterial differences. In both cases,

[3] The following distinctions were pointed to by the Third Circuit in *Kann* (pp. 250–251): (a) the taxpayers there, unlike Wilcox, were never prosecuted for the embezzlement; (b) Wilcox was not forgiven by his victim, but in *Kann* there was no proof that the unauthorized withdrawals of funds from the corporation were not condoned by the family-member stockholders; (c) taxpayers Kann were able to make restitution, but Wilcox was not; (d) Wilcox was merely a salaried employee, whereas taxpayers Kann owned directly and beneficially their two wholly dominated employer-corporations; (e) taxpayers Kann resorted to fraud over a period of six years in pursuance of a clear tax evasion scheme, absent in *Wilcox*. Substantially all of these distinctions also exist in the present case.

the misappropriating taxpayers were the principal corporate officers and, though not stockholders, owned beneficial interests in the respective family corporations which they dominated.[4] In both cases, the dominant corporate officers utilized their respective positions to divert corporate funds to their own use and benefit and asserted personal dominion over the diverted monies. The Third Circuit held that the officers in *Kann* realized taxable income by their misappropriations. The court below, making no attempt to distinguish *Kann*, and relying instead on the dissent in that case, has reached the opposite conclusion.

2. The conflict between the present decision and the *Kann* case brings into sharp focus, as is noted in Judge Hincks' dissenting opinion below (Appendix, *infra*, pp. 5a–6a), the difficulty of attempting to reconcile *Wilcox* and *Rutkin*. The four dissenting Justices in *Rutkin* considered (p. 140) that "beyond doubt" the majority there had rejected "the Wilcox interpretation of Section 22 (a)". That *Rutkin* at least went far in this direction is abundantly clear from the categorical holding in *Rutkin* (pp. 137–138) that—

[4] Taxpayers Kann held no stock in the Globe Steel Abrasive Company, one of the corporations from which they misappropriated the funds there in question. That was a wholly owned subsidiary of the Pittsburgh Crushed Steel Company in which they, together with members of their families, owned at least 90 per cent of the stock during all years involved, except 1936. *Kann* v. *Commissioner*, *supra*, p. 251.

> There has been a widespread and settled administrative and judicial recognition of the taxability of unlawful gains of many kinds under Section 22 (a). The application of this section to unlawful gains is obvious from its legislative history. * * *
>
> There is little doubt now that where unlawful gains are secured by the fraud of the taxpayer they are taxable.

The Court said further (p. 137) that—

> There is no adequate reason why assailable unlawful gains should be treated differently in this respect from assailable lawful gains. Certainly there is no reason for treating them more leniently. * * *

It was, of course, not necessary to the decision in *Rutkin* that *Wilcox* be expressly overruled. But, by limiting *Wilcox* to its facts without further indicating whether that case still possessed vitality as a precedent, the *Rutkin* opinion has proved to be a source of difficulty to the lower courts. Thus, although the majority in *Kann*, referring to this Court's decisions, found (p. 249) "a conflict of views", it concluded that *Rutkin* was controlling (p. 250) "in view of the gloss put on the *Wilcox* case by the *Rutkin* decision." It proceeded, as we have noted (fn. 3, *supra*, p. 10), to enumerate all the possible facts which would distinguish *Kann* from *Wilcox*.[5] Judge

[5] Compare *National Carbide Corp.* v. *Commissioner*, 336 U. S. 422, 427–433, for a comparable treatment of *Southern Pacific Co.* v. *Lowe*, 247 U. S. 330, another case that had been previously limited to its facts.

Kalodner, in his dissent in *Kann*, expressed the views that *Wilcox* still governs whenever the unlawful income is derived by embezzlement, that the lower courts ought not to assume that *Wilcox* was, in effect, overruled by *Rutkin* since (p. 252) "the Supreme Court of the United States can and should speak for itself", and (*ibid.*) that "[u]ntil the Supreme Court tell us otherwise, we are required to follow *Wilcox* in embezzlement cases."

The majority of the court below, like Judge Kalodner in *Kann*, did not think (Appendix, *Infra*, pp. 4a–5a) that "Rutkin completely obliterated Wilcox," and held that the latter rather than the former governed "a simple case of embezzlement." Judge Hincks, in his dissenting opinion, while sharing the difficulty of distinguishing the rationale of *Rutkin* from that of *Wilcox*, thought that the facts here are closer to the former, and added (Appendix, *infra*, p. 6–a), "And if such facts are not enough to distinguish the case here from *Wilcox*, I think the court below was right in following the later pronouncement of the Supreme Court."

In other cases, too, the lower courts, in the intervening 3½ years since the decision in *Rutkin* was handed down by this Court (March 24, 1952), have made evident their uncertainty as to the status of *Wilcox* in view of the Court's statement in *Rutkin* (p. 138) that the factual